Balhoff & Williams, LLC

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April 12, 2012

By Electronic Filing

Marlene H. Dortch
Secretary
Federal Communications Commission
Room TW-A325
445 12th Street, SW
Washington, DC 20554

Re: Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; Establishing Just and Reasonable Rates for Local Exchange Carriers, WC Docket No. 07-135; Connect America Fund, WC Docket No. 10-90; High-Cost Universal Service Support, WC Docket No. 05-337; A National Broadband Plan for Our Future, GN Docket No. 09-51; Federal-State Joint Board on Universal Service, CC Docket No. 96-45

Dear Ms. Dortch:

Francis X. Gallagher, Jr. and I met in person, and our partner, Bradley P. Williams, participated by telephone, in a meeting at the FCC's offices with Michael Steffen, Carol Mattey, Travis Litman, and Patrick Halley; Deena Shetler of the FCC staff participated by telephone.

In anticipation of Ms. Shetler's participation via telephone, the attached presentation was sent to Ms. Shetler via email prior to the meeting. Accordingly, a copy of this presentation is hereby filed with the Commission pursuant to Section 1.1206 of the FCC's rules.

We were not representing any companies, associations, or other parties, nor are we or our financial advisory firm being compensated for our participation in this briefing. The session focused on our professional opinions related to the financial effects of the USF/ICC Transformation Order. We discussed the likely lower levels of investments in broadband and telecommunications assets due to the uncertainties surrounding future cash flow contractions in access-related funds and universal service funds. Further, we explained our experience in dealing with debt and equity investors who believe that the risk associated with investing in rural regions is increased significantly due to factors such as those outlined in the attached presentation.

Please contact me if you have any questions.

Sincerely,
/s/
Michael J. Balhoff

Balhoff & Williams, LLC
5457 Twin Knolls Road, Suite 101
Columbia, MD 21045

cc: Michael Steffen
Carol Mattey
Travis Litman
Patrick Halley
Deena Shetler

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Briefing for FCC

Federal Reforms: Financial Insights

Michael J. Balhoff, CFA
Francis X. Gallagher, Jr.
Bradley P. Williams

April 10, 2012

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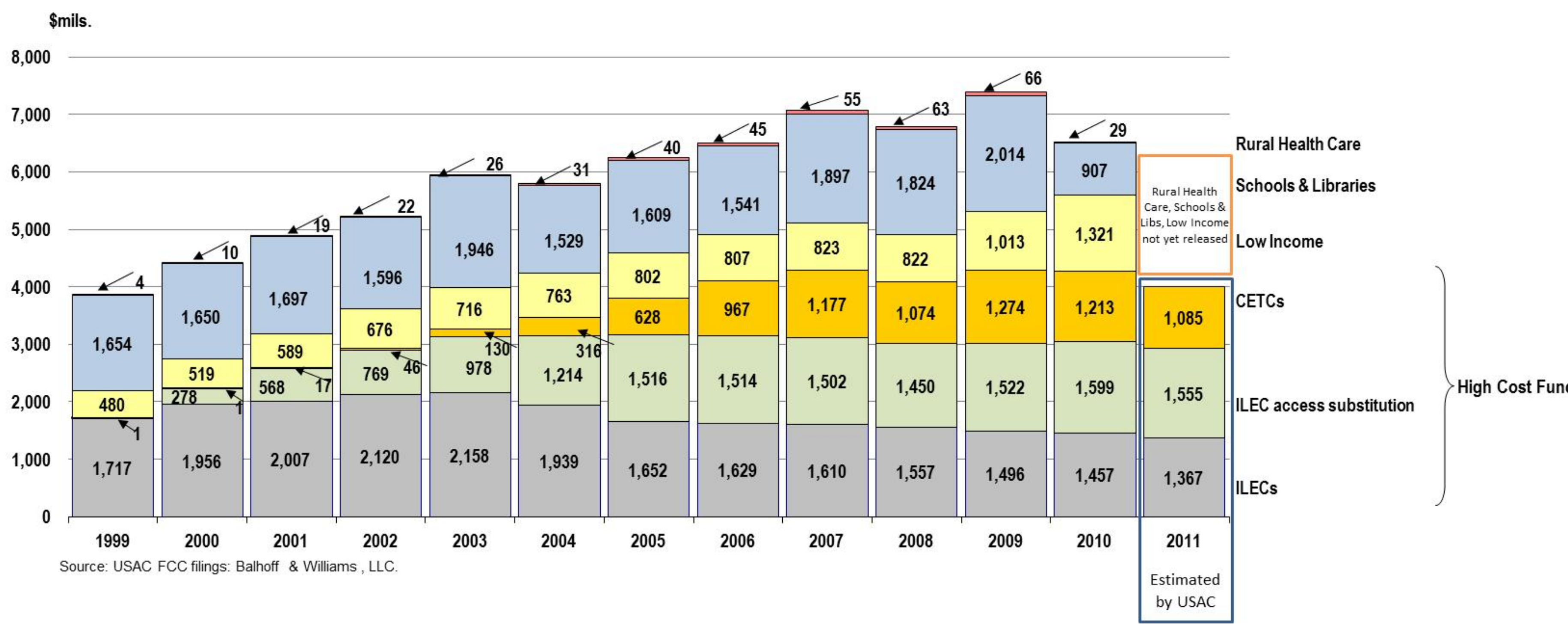
Preliminary Comments

- Balhoff & Williams and Charlesmead Advisors are not representing any other parties
- Perspective is based on . . .
  - Financial experience in serving investors and companies in rural telecommunications
  - Recent assignments related to growing financial challenges
- Purpose of session
  - To clarify our financial conclusions related to rural telecommunications that . . .
    - Investment is likely to be reduced in high-cost regions among traditional RLECs
    - Cost of capital is likely to grow higher
    - Access to capital is likely to be reduced
    - Defaults are likely to affect lenders in the sector
    - More financial uncertainty due to “retroactive” regulatory recovery rules and “rigorous” waiver process
    - Unclear path to a viable operating model in high-cost regions
  - To discuss approaches to improve the net financial outlook

Policy Drivers of Fund Growth



Source: USAC FCC filings: Balhoff & Williams , LLC.

- Incumbent local exchange carrier (ILEC) non-access funding is down from $2.16 billion in 2003 to $1.37 billion in 2011
- Total ILEC USF from 2004 to the present, slipping from $3.15 billion to $2.92 billion
- The growth in the overall USF is due to new policy factors since 2003

Critics of Legacy USF

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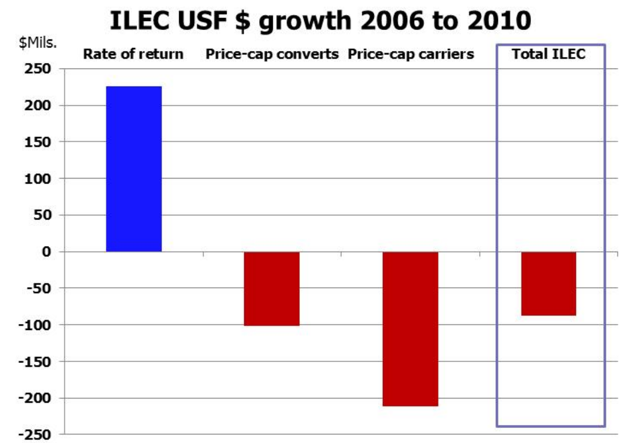
- Critics too-simplistically suggest that the former USF supported an antiquated network
  - Regulation, in fact, focused on circuit-switched networks
  - However, virtually all ILECs were/are investing in the most modern networks in support of customer-focused IP services, fiber, and backbones for wireless services
  - Wired services are valuable for businesses / wireless access
  - In high-cost areas (generally outside rural town centers), customers will be challenged to pay rates that support network costs that are much higher than in urban areas



Source: FCC Feb 2011 NPRM on ICC/USF reform

- Critics also wrongly contend that USF should go down as lines are lost; however . . .
  - In a high fixed-cost business, investment and other costs do not decline at the same rate as line losses, because the original investment must be amortized/maintained/recovered over years
  - ILECs appear to be losing denser, low-cost customer base first, not the higher-cost customers
  - ILECs are deploying lower-margin broadband services requiring high investment/high operating costs (thus, they are supporting new, more costly services not captured in access-line statistics)
- General recognition of outdated ICC; critics argue against making implicit support explicit
  - Telecom Act called for making funds "explicit"
  - Reform implements "bill-and-keep," a solution good for much of the industry, but inflicting collateral damage on rural-centric carriers if rates cannot be raised sufficiently
  - New USF (Connect America Fund) offset may be available but shape/size is not yet clear

The Changing Landscape

- Telecom Act at 254
- Competitive market has evolved as new technologies emerged
  - Wireless, broadband, IP adoption, etc.
  - Loss of access lines
  - Increased competition where rational competition can exist
  - Where network is costly, ILEC is primary or only provider and network reflects support levels
  - Wireless growth profile is slowing
- FCC's Transformation USF/ICC Order
  - Need for reforms apparent
  - Major issue was whether to increase the fund to offset ICC reductions
  - Headlines accompanying reforms
    - Modernizes America's communications infrastructure
    - Commitment to more universal broadband, benefiting new jobs in deployment / better graduation rates
    - Consumer economic benefits, including annual economic growth and more jobs
    - Accountability for use of funding

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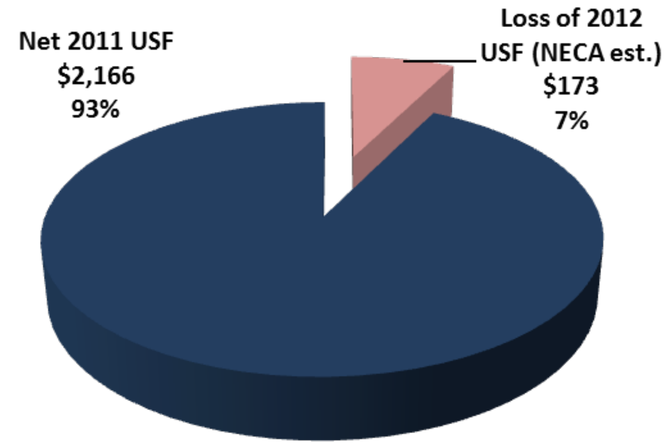
Rural Financials

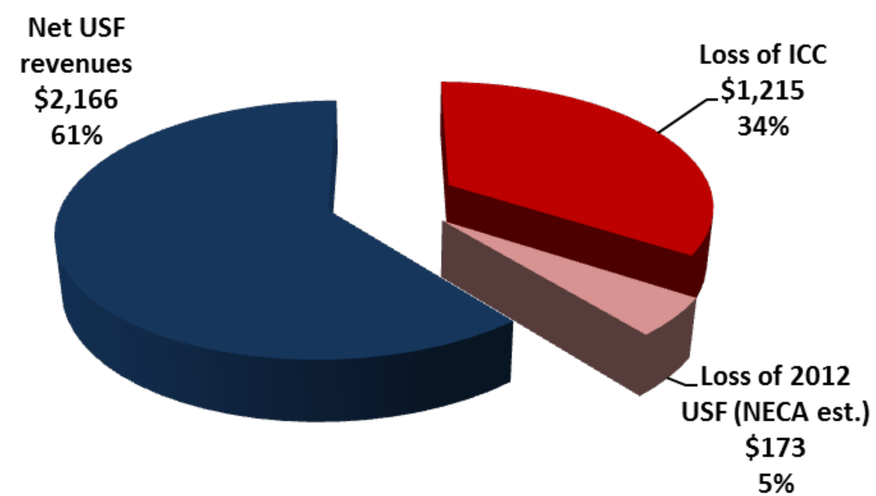
	2012	Long-term effects of initial reform	Pending "reforms"
USF +	Caps and other limits reduce rural funding by estimated $173+ mil.	USF remains capped; carriers hesitant to accept restrictive obligations without sufficient funding; CAF not defined	More reductions: proposed ROR, ICLS, $250 cap target in 3 steps, comp. overlay, low rate adj.
Access funding +	Wireless recip comp and initial step-down in intrastate access revenues	Estimated $1.215 billion in rural-related total access revenues	Orig. access (~$500 mill)
Competitive pressures =	Challenge in increasing end-user rates; ongoing losses in denser, more profitable regions; shift of operations toward unprofitable regions		
Net effect	*Reductions in cash flows; in uneconomic regions*	*Net reduced cash flow from access and USF*	*Re-prescription reduces cash flows / raises risk*

- Financial effects for rural-centric wireline carriers
  - USF/CAF capped or reduced, estimate of revenue loss for 2012 appears conservative
  - Access/intercarrier revenue contracts
  - Competitive pressures focused on profitable regions
  - ILECs left with larger proportion of high-cost, uneconomic regions
  - Re-prescription at a time when all risks are increasing
- Effects are negative even for larger price-cap LECs with small or no IXC operations

Approximate Revenue Outlook

- Rural USF loss (conservative estimate assuming cap on ICLS as signaled)
- A more complete, longer-term view (second pie chart) includes all of ICC plus USF (based on 2011 rural receipts of access and USF)
  - ICC partially recovered in higher rates and ARC/RM, but ARC/RM plan signals reductions over time
  - Projected eventual loss could be about 40% of 2011 total of (i) access (with full effect in 9 years) and (ii) USF revenues (there are potential CAF funds with new obligations)
  - The ILECs' total revenue effect/loss may be offset by rate increases, which could lead to more rapid line loss
- However, USF/ICC *revenues* are not the appropriate financial perspective—cash flows losses should be the focus





Source: USAC data and estimates by Balhoff & Williams, LLC

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Focus on Operating Cash Flow

Sensitivity of Operating CF to Percentage of Revenues Lost

		Percentage of revenues lost					
		5%	**10%**	**15%**	**20%**	**25%**	**30%**
Operating CF margin	**15%**	33%	67%	100%	133%	167%	200%
	20%	25%	50%	75%	100%	125%	150%
	25%	20%	40%	60%	80%	100%	120%
	30%	17%	33%	50%	67%	83%	100%
	35%	14%	29%	43%	57%	71%	86%
	40%	13%	25%	38%	50%	63%	75%
	45%	11%	22%	33%	44%	56%	67%
	50%	10%	20%	30%	40%	50%	60%

- What appears to be minimal revenue impact can be substantial in terms of cash flow
- If minimal reduced costs are associated with revenue loss, larger effects on op. cash flow
- The table above assumes no reduction in costs when USF or access revenues are lost
- For example . . .
  - 10% loss of revenues and an operating cash flow margin of 40% with no reduction in costs results in a 25% loss of operating cash flow
  - 10% loss of revenues and an operating cash flow margin of 30% results in a 33% reduction in operating cash flow
- Cash flows that contract sharply put pressure on interest payments, appropriate returns to equity holders, principal repayment, capex and new business development

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Quantile Regression Analysis

- Pressure on USF receipts could be greater still over time . . .
- FCC's new statistical tool to cap recovery for capital expenses and operating expenses—Quantile Regression Analysis
  - Focus on rate-of-return carriers
  - Each year, FCC will release updated capped values for 11 of 26 elements in HCL algorithm
  - Potential application to Interstate Common Line Support
- Concerns about approach, including in peer reviews from FCC economists
  - New uncertainties created year-to-year
  - Individual analyses of specific costs do not take into consideration other related saved costs
  - System will create downward pressure each subsequent year
  - Investors focused on . . .
    - Unpredictability of annual mechanisms
    - Widespread concern over QRA being applied "retroactively" which significantly undercuts investors' confidence in relying on crucial regulatory systems going forward
    - Waiver process

Focused Financial Commentary

- USF reform appears focused on fund size rather than assessing sufficiency
  - Mechanisms are based on “blunt” tools
  - Reform assumes ongoing reductions lead to viable model in meeting universal service obligations
- ICC reform is the potential major factor
  - FCC’s assumption (*e.g.*, Order, 36 and 39) that ICC reform is better than the *status quo*
    - Assumes that ICC should go away approximately in line with IXC revenues (assumes no implicit support in ICC rates)
    - Assumes minimal impact on ILECs because of focus on minimal revenue effects instead of larger cash flow effects
    - Avoids whether some/all of ICC should have been converted previously to stable/sufficient support mechanism
    - If support exists in ICC, bill-and-keep is tantamount to a major cut in total “USF” assuming that ARC/RM are transitional
  - Major reductions in ICC will have predictably negative effect on investment and capital
- Financial problems are already discernible and are expected to grow more severe
  - Cash flow reductions and retroactivity have shaken the financial community
    - Lenders are signaling restrictive loans—higher rates, less/no access to capital, stricter covenants
    - Equity investors have relied upon predictable rules by which to analyze the sector
    - Unclear viable long-term operating model in high-cost regions
  - Some ILECs already signaling probable bankruptcy in near term, which could affect all lenders, including the government’s RUS cost ratings, future access to funds, rates, and policy
  - Large carriers and small are reconsidering their investment in rural regions
    - Verizon has long ago pulled back from rural regions
    - AT&T comments in 4Q11 earnings call about rural M&A
    - Mid-size and small carriers—price-cap and ROR—are looking to contract investment and personnel
    - Potential underinvestment in rural wireless (see Tellabs report 2011)
- Financial shape of reforms for rural-focused ILECs increases the policy and political risk

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Potential/Probable Outcomes

Operating

- Reduced or eliminated near-term capital investment
- Proximate reductions in personnel and other operating costs
- Conservation of cash to survive rather than invest

Financial

- Increased cost of capital driven by evolving regulatory rules
- Problematic recovery on investment, especially recent fiber investments
- Skepticism about or avoidance of sector by debt and equity investors
- Companies will evaluate consolidation, made more complex by financial risks and concern over potential bankruptcies
- ICC reform is net transfer of wealth to IXCs (Order assumes 75% pass-through to customers with no specific obligation to do so)

Customer service

- Less or no wired-broadband deployment in unserved or underserved regions
- Growing urban-rural divide in terms of investment and telecommunications services
- Rates will rise in high-cost rural regions for services that will likely be less than comparable to those in urban areas

Policy

- USF mechanisms may no longer be predictable and sufficient
- COLR becomes more problematic if underfunded or unfunded
- Services will no longer be "comparable" in urban and rural regions, especially if new rural wireless investment does not materialize
- Potential exists that private-public partnership fails

Senior Professionals

FRANCIS X. GALLAGHER, JR., MANAGING PARTNER

Francis X. Gallagher, Jr., is Managing Partner and Co-Founder of Charlesmead Advisors, LLC. Mr. Gallagher has executed a wide range of financing and merger and acquisition assignments in his 15 years as an investment banker. Representative buy-side advisory assignments in the wireline arena include the representation of Iowa Telecommunications in its acquisition of Sherburne TeleSystems, and TDS in its acquisition of managed services provider Visi Incorporated. Representative sell-side transactions include the representation of Lakedale Telephone in its sale to Iowa Telecommunications and Hutchinson Telephone in its sale to New Ulm Telcom. In the wireless sector, Mr. Gallagher has advised Sprint affiliates Northern PCS, Gulf Coast Wireless and Enterprise PCS in their respective sales to Sprint Nextel, and also advised Blackfoot Telephone Cooperative in the sale of its wireless division to Alta Communications.

Prior to co-founding Charlesmead Advisors, Mr. Gallagher spent almost 15 years at Legg Mason and Stifel Nicolaus, where he headed the Telecommunications & Media Investment Banking Group. Prior to becoming an investment banker, Mr. Gallagher practiced mergers and acquisitions and securities law. Mr. Gallagher began his career at New York-based Winthrop, Stimson, Putnam & Roberts where he was resident for three years in that firm's London office. Mr. Gallagher holds a B.A. degree from Georgetown University, where he graduated *cum laude*, and a law degree from Georgetown University Law Center. He serves on the Board of Directors of the Baltimore Development Corporation and is Chairman of the Board of Saint Frances Academy, the oldest African American Catholic High School in the United States.

MICHAEL J. BALHOFF, CFA, SENIOR PARTNER

Michael J. Balhoff, CFA, is a Senior Partner and co-founder at Charlesmead Advisors, LLC, and is Managing Partner at Balhoff & Williams, LLC, a professional services firm that provides financial-regulatory consulting and advisory services to companies, investors and policymakers in the communications and energy industries. Before founding the predecessor firm to Balhoff & Williams, Mr. Balhoff headed the Technology and Telecommunications Equity Research Group at Legg Mason and, in the final seven of his sixteen years as a senior analyst at Legg Mason, he covered equities in the incumbent local exchange carrier industry. Prior to joining Legg Mason in 1989, Mr. Balhoff taught as a graduate and undergraduate teacher. Mr. Balhoff has a doctorate in Canon Law and four master's degrees, including an MBA—concentration finance—from the University of Maryland. He is a CFA charterholder and is a member of the Baltimore Security Analysts Society. Mr. Balhoff has been named in six annual awards as a Wall Street Journal All-Star Analyst for his recommendations on the Telecommunications industry. His coverage of telecommunications, and especially rural telecommunications, was named by Institutional Investor magazine as the top telecommunications boutique in the country in 2003.

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Senior Professionals

BRADLEY P. WILLIAMS, JD, SENIOR PARTNER

Bradley P. Williams, JD, is a Senior Partner and co-founder at Charlesmead Advisors, LLC, and also is a Partner at Balhoff & Williams, LLC. Mr. Williams joined the predecessor firm to Balhoff & Williams in 2005 and became a Partner at Balhoff, Rowe & Williams in 2007. Previously, Mr. Williams was a member of the Strategic Planning & Business Development group at Lowe's Companies Inc., the Fortune 50 home improvement retailer. Prior to joining Lowe's, Mr. Williams worked with Mr. Balhoff in the award-winning Telecommunications Equity Research Group at Legg Mason, focusing on incumbent and rural local exchange carriers. Prior to joining Legg Mason, Mr. Williams was a co-founder of eSprocket / Beachfire, a venture-backed company that evolved into one of the pioneers in mediation technology solutions for the financial services sector. Previously, he served as a financial executive for a holding company that integrated, through acquisitions, a significant regional freight rail network. After being admitted to the North Carolina Bar, Mr. Williams began his career as an investment banker focusing on private financings and transactional advisory services in First Union's Capital Markets Group. He has a BA in Economics from the University of North Carolina and a JD from the University of North Carolina School of Law.

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Representative Transactions

PEOPLES Has Agreed to sell Spectrum to at&t Advisor to Seller *Pending*	Smith Bagley, Inc. Has Acquired Spectrum from LICT CORPORATION Advisor to Buyer *February 2012*	EATEL Has Acquired VISION Advisor to Buyer *January 2012*	North State Communications Has Acquired DataChambers Advisor to Buyer *December 2011*	TDS Has Acquired VISI Advisor to Buyer *March 2010*	$82,000,000 Iowa Telecom Has Acquired Sherburne Tele Systems, Inc. Advisor to Buyer *July 2009*	Has Sold Certain Assets to Commnet Wireless a subsidiary of Atlantic Tele-Network Advisor to Seller *December 2008*	Lincolnville Telephone Company Has Been Acquired by Shephard Hill Financial Advisor *August 2008*	$43,900,000 Lakedale Has Been Acquired by Iowa Telecom Advisor to Seller *July 2008*	SureWest Wireless Has Sold its Wireless Operations to verizon wireless Fairness Opinion *January 2008*
$78,000,000 Hutchinson Telephone Company Has Been Acquired by NU-Telecom Advisor to Seller *January 2008*	$312,500,000 Northern Has Been Acquired by Sprint Advisor to Seller *August 2007*	$600,000,000 clearwire wireless broadband Common Stock Co-Manager *March 2007*	WVT Communications Financial Advisor *November 2006*	$10,200,000 Has Been Acquired by FairPoint communications Advisor to Seller *November 2006*	$135,100,000 Hector Communications Corporation Has Been Acquired by Hector Acquisition Corp. Advisor to Seller *November 2006*	$72,960,000 ATN Common Stock Co-Manager *July 2006*	$98,000,000 Enterprise Has Been Acquired by Sprint Advisor to Seller *January 2006*	$287,500,000 GCW Has Been Acquired by Sprint Advisor to Seller *October 2005*	Blackfoot Has Sold Certain Assets to Alta Communications Advisor to Seller *August 2005*
Nsight Services Financial Advisor *August 2005*	CMS Has Been Acquired by verizon wireless Advisor to Seller *March 2005*	$350,000,000 CenturyTel Senior Notes Co-Manager *February 2005*	$506,718,750 Valor Telecom Common Stock Co-Manager *February 2005*	$84,125,010 ACS Common Stock Co-Manager *January 2005*	Horizon Chillicothe Telephone Fairness Opinion *December 2004*	$417,580,005 Iowa Telecom 21,977,985 Shares Common Stock Co-Manager *November 2004*	MobileTel Has Been Acquired by Alltel Advisor to Seller *October 2004*	Comporium Group Has Acquired PBT Financial Advisor *April 2004*	$374,220,000 Nextel Partners Inc Common Stock Co-Manager *November 2003*
$500,000,000 Nextel 6.875% Senior Notes Co-Manager *October 2003*	Devon Mobile Communications, L.P. Has Sold Certain Assets in Pennsylvania to verizon wireless Advisor to Seller *September 2003*	Devon Mobile Communications, L.P. Has Sold Certain Assets in New England to U.S. Cellular Advisor to Seller *September 2003*	$300,000,000 CTE 3.25% Convertible Notes Co-Manager *July 2003*	$450,000,000 Nextel Partners Inc 8.125% Senior Notes Co-Manager *June 2003*	Devon Mobile Communications, L.P. Has Sold Certain Assets in Virginia to T-Mobile Advisor to Seller *April 2003*	GCW Financial Advisor *March 2003*	$165,946,410 CTE 4,741,326 Shares Common Stock Co-Manager *December 2002*	$500,000,000 CenturyTel 7.875% Senior Notes Co-Manager *August 2002*	$350,300,000 CEI Has Merged with D&E Advisor to Seller *May 2002*